



THE UNIVERSITY *of* EDINBURGH

Edinburgh Research Explorer

Board diversity as a corporate governance tool

Citation for published version:

Valsan, R, *Board diversity as a corporate governance tool*, 2013, Web publication/site, Edinburgh Centre for Commercial Law Blog (ECCL Blog). <<http://www.ecclblog.law.ed.ac.uk/2013/12/02/141/>>

Link:

[Link to publication record in Edinburgh Research Explorer](#)

Document Version:

Publisher's PDF, also known as Version of record

Publisher Rights Statement:

© Valsan, R. (Author). (2013). Board diversity as a corporate governance tool. Edinburgh Centre for Commercial Law Blog (ECCL Blog).

General rights

Copyright for the publications made accessible via the Edinburgh Research Explorer is retained by the author(s) and / or other copyright owners and it is a condition of accessing these publications that users recognise and abide by the legal requirements associated with these rights.

Take down policy

The University of Edinburgh has made every reasonable effort to ensure that Edinburgh Research Explorer content complies with UK legislation. If you believe that the public display of this file breaches copyright please contact openaccess@ed.ac.uk providing details, and we will remove access to the work immediately and investigate your claim.



Board diversity as a corporate governance tool

Posted on [December 2, 2013](#) by [Remus Valsan](#)

On November 20, the European Parliament [approved](#) the European Commission's legislative proposal to improve the gender balance in company boards. The [proposed directive](#) sets a minimum threshold of 40% of the under-represented sex in non-executive board-member positions in listed companies and a "flexi quota" (self-imposed targets) for executive directors, to be met by 2020. If the proposal becomes law, publicly listed companies with less than 40% of women among their non-executive board members will be required to adopt a selection procedure for board members, which gives priority to qualified female candidates. Small and medium-sized enterprises, while not bound by this requirement, will be encouraged to improve the gender balance at all levels of management and on boards.

Corporate board diversity (mostly in the form of gender diversity) has been a very dynamic area of corporate governance in Europe over the past decade. Norway is the frontrunner in the reforms promoting gender diversity, with a 40% quota of women on boards imposed on publicly listed companies since 2003. Several other European countries, including Spain, France, Belgium and Netherlands, have passed laws imposing quotas of women representation on board.

UK regulators preferred a soft law approach. The UK Corporate Governance Code recommends that board members be appointed "on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender" (principle B.2). In 2010, the UK Government commissioned Lord Davies to investigate the barriers preventing women from reaching senior decision-making roles in corporations. Davies' report of [2011](#), with follow-ups in [2012](#) and [2013](#), maintained the soft law approach by recommending a voluntary, disclosure-based, strategy aimed to create a culture of diversity from within corporations.

Board diversity is, unsurprisingly, a very hot topic in academic research as well (for recent examples see Ferreira 2010; Broome et al., 2011; Dobbin & Jung, 2011). From a corporate governance perspective, however, the concrete ways in which board diversity contributes to better corporate governance and increased firm value are not altogether clear. The evidence drawn from empirical research is mixed and inconclusive. While academics may be suspected of being disconnected from the practical aspects of everyday life, business practitioners, it seems, are none the wiser. A recent study has shown that, despite showing an almost universal assent to the value of diversity *in abstracto*, corporate directors and officers have difficulty providing specific concrete examples of instances or ways in which diversity adds value to their boards (Broome et al., 2011).

The studies on the relation between board diversity and corporate performance have identified several main benefits and costs of diversity. On the benefits side, the positive business effects of board diversity include:

- improved access to information, increased creativity and more effective problem-solving
- better understanding of the marketplace, customers and suppliers
- improved relations with employees, by signalling that the company values diversity and offers mentoring and advancement opportunities for all groups of employees
- improved public image, by conforming to societal expectations

On the costs side, the potential downsides of diversity include:

- decreased cohesion in the board, resulting in distrust, lack of cooperation and breakdown in communication
- a lengthier and more costly decision-making process
- decrease of quality of decisions, due to insufficient business expertise of directors chosen on diversity criteria
- enhanced conflicts of interest by directors aiming to promote agendas or ideologies

From a corporate governance perspective, some of the most promising arguments in support of diversity are those linking diversity with directors' improved ability to discharge their main duties. The first duty that comes to mind is the duty of care, skill and diligence (s. 174 of Companies Act 2006). The improved access to information, the diversity of viewpoints, and the greater scope for debates could increase the quality of business judgment and the outcomes of board deliberations.

Another example is directors' duty to take into account the interests of relevant stakeholders, while promoting the success of the company as a whole (s. 172 of Companies Act 2006). Board diversity may help directors weigh more accurately the relevant considerations by helping to correct some of their prejudices and biases (Langevoort 2011). The different traits or characteristics associated with a certain ethnicity or gender create cognitive and behavioural diversity in the boardroom, which in turn may lead to a more balanced weighting of relevant considerations for each decision. Another way in which diversity could improve compliance with this duty is the difference between male and female directors in terms of self- and other- orientation: it has been argued that women directors have a greater "other-orientation" (Langevoort 2011), and hence are more committed to the development of stakeholder relationships and the long-term firm value.

Board diversity may also assist non-executive directors in discharging their oversight duty, requiring them to scrutinise the executive directors' performance and the company's system of financial controls and risk management (UK Corporate Governance Code, Principle A.4). A diversified board increases non-executives' independence by reducing the probability of "groupthink". Groupthink is a feature of homogenous groups, manifested in loss of individual creativity and independent thinking due to loyalty to group norms and desire for harmony (Janis 1972). Diverse boards undermine the homogeneity required by groupthink and reduce the likelihood of uncritical rubber-stamping of management's decisions.

These avenues of research could bring important insights into the value of diversity as a corporate governance tool. In all advanced societies of today it is unacceptable to doubt the value of diversity, and rightfully so. In the context of corporate governance, the attempt to find a more concrete causal links between board diversity and good corporate governance does not call into question the intrinsic value of diversity within the firm. On the contrary, this exercise will provide contextual evidence to support diversity as an overarching value.

Bibliography:

Lisa L. Broome, John M. Conley and Kimberly D. Krawiec, "Dangerous Categories: Narratives of Corporate Board Diversity" (2011) 89 North Carolina Law Review 759

Frank Dobbin and Jiwook Jung, "Corporate Board Gender Diversity and Stock Performance: The Competence Gap or Institutional Investor Bias" (2011) 89 North Carolina Law Review 809

Lisa M. Fairfax, "The Bottom Line on Board Diversity: A Cost-Benefit Analysis of the Business Rationales for Diversity on Corporate Boards" (2005) Wisconsin Law Review 796

Daniel Ferreira, "Board Diversity" in H. Kent Baker and Ronald Anderson, eds., *Corporate Governance: A Synthesis of Theory, Research, and Practice* (Hoboken, N.J: Wiley, 2010) 225-243

Irving L. Janis, *Victims of Groupthink: A Psychological Study of Foreign-Policy Decisions and Fiascos* (Boston: Houghton Mifflin, 1972)

Google Analytics
Gravatar

Donald C. Langevoort, "Puzzles about Corporate Boards and Board Diversity" (2011) 89 North Carolina Law Review 841.

This entry was posted in [Uncategorized](#). Bookmark the [permalink](#).

4 Responses to *Board diversity as a corporate governance tool*



[First Flight NED](#) says:

December 17, 2013 at 11:03 am

Interesting post with some great facts. I completely agree with Langevoort (2011) reference.

[Reply](#)



[Ashley Ray](#) says:

January 22, 2014 at 12:43 pm

I must admit that this is a great read. You make some interesting observations.

[Reply](#)



[Ashley Ray](#) says:

January 22, 2014 at 12:44 pm

I have to agree that it is imperative to have diversity on the board otherwise there is a huge risk of conflict of interest.

[Reply](#)



[Emmanuel Ikott](#) says:

June 4, 2014 at 12:20 pm

Great analysis .Corporate governance diversity with respect to gender . Keep it up. It Apiece of work.

[Reply](#)

The ECCLblog

Proudly powered by [WordPress](#).